IN THE

Supreme Court of the United States

OCTOBER TERM, 1949.

No. 843

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

HELEN C. BROWN and EARL M. BROWN, *Respondents*.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

BRIEF FOR THE RESPONDENTS IN OPPOSITION

OPINIONS BELOW.

The findings of fact and opinion of the Tax Court (R. 29-38), together with the dissenting opinion (R. 39-40), are reported at 12 T. C. 1095. The majority and dissenting opinions of the Court of Appeals (R. 48-54), are reported at 180 F. 2d 926.

JURISDICTION.

The judgments of the Court of Appeals were entered on February 28, 1950 (R. 54-55). The petition for a writ of certiorari was filed on May 26, 1950. The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

QUESTION PRESENTED.

Where the Tax Court finds as facts (1) that the taxpayers made irrevocable transfers of properties (2) to an independent trustee and then (3) paid the trustee reasonable amounts for the use of the properties, should the transactions be ignored and the petitioners be deprived of the statutory right to deduct as business expenses the reasonable amounts so paid for the use of the properties?

STATUTE INVOLVED.

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) EXPENSES.—

(1) TRADE OR BUSINESS EXPENSES.—

(A) IN GENERAL.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * * and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

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(26 U. S. C. 1946 ed., Sec. 23.)

STATEMENT.

The facts as set forth on pages 4-10 of the petition are correct.

While the Commissioner in his petition (p. 10) referred to six judges of the Tax Court dissenting, it should be remembered that the only judge who heard the testimony and studied the demeanor of the witnesses on the stand was Judge Arundell. He wrote the dissenting opinion in the Tax Court (R. 1, 3, 39-40).

With the addition of the foregoing procedural fact, the taxpayers see no need for making a counterstatement.

ARGUMENT.

Throughout the petition for certiorari and in the dissenting opinion in the Court of Appeals (R. 53) the suggestion is made that the Court of Appeals was trespassing upon the fact finding jurisdiction of the trial court.

Rule 52 (a) of the Federal Rules of Civil Procedure provides in part—

> Findings of fact shall not be set aside unless clearly erroneous, and *due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses.* (Italics supplied.)

This rule is believed to apply to review of Tax Court decisions. 26 U. S. C. A. § 1141 (a).

The question that immediately arises where, as here, the Tax Court judge who heard the case is overruled by his associate judges is—what is meant by the "trial court" in cases before the Tax Court?

Obviously, the only judge who had an opportunity to consider the credibility of the witnesses was Judge Arundell (R. 1, 3). He concluded in part in his dissent (R. 40)—

> I can detect no sham in the transaction entered into by petitioners [taxpayers] with the two trusts.

It was his associates on the bench—sitting in effect as a reviewing body—who looked at the cold record and decided the case for the Commissioner. And it is this so-called "first review" of the factual situation by the Tax Court in banc that the Commissioner contends should be controlling as against the conclusion of the judge who heard the case and as against the opinion of the Court of Appeals.

Respondents submit that in the absence of any discrediting findings of fact by the only judge who heard the witnesses, the Court of Appeals was just as much at liberty to review the case as was the majority of the Tax Court.

1. On page 13 of his petition the Commissioner asserts that:

> * * * the "rents" and "royalties" were not fixed amounts which might very well bear little relation to how the partnership enterprise would fare * * *.

But certainly a fixed charge for each ton of coal removed from the property or loaded over a railroad siding (R. 34) is a "fixed amount" and must be paid whether the product is ultimately sold at a profit or at a loss.

The Commissioner next asserts in his petition (p. 13) that—

> * * * what the taxpayers gave to their children was income from the business, and not a remainder in the real property transferred.

Again, it is submitted that the Commissioner's statement is misleading. The title to both properties was *in fact* transferred to the trustee for the children (R. 32, 58; Exhibits 9-I, 10-J; Tr. 24-25) and the agreed rentals had to be paid without regard to whether the partnership realized income from its use of the property (R. 52). Moreover, it is not shown, as the Commissioner states (petition, p. 13), that the railroad siding apparently had little, if any, value except to the taxpayers. The Commissioner's citation, (R. 35), shows only that Mr. Bigler, who had apparently

reserved a limited use of the property (R. 58; Exhibit 11-K; Tr. 25-26, 111), paid only $26.00 in the year involved. If the property was of as little value as the Commissioner implies, it is unlikely that the Tax Court would have found a 7¢ rental to be a reasonable rate, in the year involved, particularly when the total amount involved was $10,203.38 (R. 34). The primary basis for the petition for certiorari is an alleged conflict in principle with cases decided by the Supreme Court involving a reallocation of income within a family group. The court below was obviously aware of the cases relied on by the government and it answered that line of thought in part as follows (R. 52):

> What is controlling is that there came into the picture *a new independent owner, the trustee,* who was in a position to and did require the payment of the rents and royalties as a condition to the continued use and possession of the lands by the taxpayers for the purposes of their business, and *wholly without regard to whether their operations resulted in taxable income.*
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> The taxpayers were legally obligated to pay the rents and royalties for the use of the siding and the mining of the coal *even though their operations had resulted in a loss.* (Italics supplied.)

The foregoing quotation seems a complete answer to the family partnership and short term trust cases with which conflicts in principle are asserted.

The first case cited by the Commissioner in his petition (p. 11), that of *Helvering* v. *Clifford,* 309 U. S. 331, involved a trust for only 5 years with the taxpayer acting as trustee, reserving practically complete control over the trust corpus during the term, and in which the corpus reverted to the taxpayer-grantor. The principle decided therein was obviously intended to apply to a temporary trust and not to irrevocable transfers made to independent trustees under trust agreements running for 20 years. Moreover, the *Clifford* case involved a determination of additional gross in-

come under the broad sweep of § 22 (a) of the Internal Revenue Code whereas here the only question is one of an allowable deduction. Cf. *Skemp* v. *Commissioner*, 7 Cir., 168 F. 2d 598, 599.

The Commissioner also relies in his petition (pp. 11-12) on the family partnership cases of *Commissioner* v. *Tower*, 327 U. S. 280, and *Commissioner* v. *Culbertson*, 337 U. S. 733. The first of these cases must be read in the light of the second and when that is done, it is apparent that the tax effect of the transactions involved must be determined by the "intent" of the parties (337 U. S. 742). And by this test, it is clear here that the taxpayers fully intended to create valid trusts and that they made the substance of the transaction and their intention clear to Judge Arundell, the trial court judge (R. 40). It necessarily follows that no conflict exists between the present case and the *Culbertson* decision.

2, 3. It is also difficult to find any particular conflict between the decision below and *Helvering* v. *Lazarus & Co.*, 308 U. S. 252, or *Deputy* v. *duPont*, 308 U. S. 488. The *Lazarus* case turned on the construction to be given certain complicated instruments and the reviewing courts simply approved the conclusion of the judge who heard the case (32 B. T. A. 633). In *Deputy* v. *duPont* the deduction was denied because it was not related to the taxpayer's trade or business (308 U. S. 494). In the case at bar, however, the taxpayers were admittedly engaged in the coal mining business (petition, p. 4), and it is clear that the payments of royalties on coal mined and rentals on the use of a siding for loading coal cars are definitely related to and part of the trade and business of the taxpayers.

4. The Commissioner suggests that this case is of some importance because of a possible tax-avoidance feature. But here the taxpayers conveyed property to a trustee for the absolute benefit of their children. Then they leased the properties at the prevailing rental and royalty rates and

used them in their business. That is all that was done here. The Commissioner seeks to color the transaction because the property was thereafter leased by the taxpayers instead of by outsiders. Since, however, the rentals paid were reasonable, the same as outsiders would have paid, it is submitted that the lease-back arrangement in no way invalidates the irrevocable transfer of the corpus involved. If there is a need for the preservation of "independent" judgment in the Tax Court on questions of fact (petition, p. 18), that judgment should certainly be preserved in the trial judge who hears the case and has an opportunity to study the witnesses. The Court of Appeals in reversing the reviewed opinion of the Tax Court, has preserved this independent judgment in the individual trial judge.

In short, it is believed that the petition for certiorari is based on the mistaken premise that the Tax Court, as a result of a study of the witnesses on the stand, has concluded that the trusts here involved were without substance (contrary to the opinion of the only judge who saw the witnesses) and that from this erroneous premise the petitioner seeks primarily to find a conflict with cases involving family partnerships or short term trusts. Since, however, the trial judge and the Court of Appeals were unable to find any lack of substance in the transactions, it follows that the majority opinion of the Tax Court was properly reversed and that the action of the Court of Appeals in ordering the reversal in no way conflicts with the established principles laid down by this Court.

CONCLUSION.

The decision below is correct. It turns upon the particular facts of the case and presents no question calling for review by this Court. There is no conflict of decisions and no question of general importance. The petition should therefore be denied.

Respectfully submitted,

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